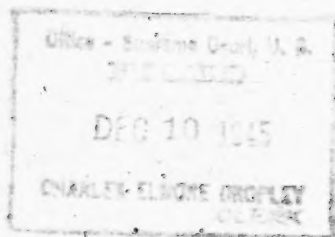


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No. 163

In the Supreme Court of the United States

OCTOBER TERM, 1945

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

LAIRD WILCOX AND MAUD WILCOX

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 16-20) is unreported. The opinion of the Circuit Court of Appeals (R. 30-33) is reported at 148 F. 2d 933.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 30, 1945. (R. 33-34.) The petition for certiorari was filed on June 25, 1945 and was granted on October 8, 1945 (R. 35). Jurisdiction is conferred on this Court by Section 240 (a) of the Judicial Code, as amended.

QUESTION PRESENTED

Whether embezzled money constitutes taxable income to the embezzler under Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless

exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

STATEMENT

The facts as stipulated (R. 9-13) and as found by the Tax Court (R. 16) are the following:

Laird Wilcox, the taxpayer, was employed as a bookkeeper by the Nevada Transfer and Warehouse Company from 1937 to 1942. During the last few years of his employment he was receiving a salary of \$200 per month which he was paid promptly when due. It was not the custom of his employer to allow him to draw his salary in advance. (R. 16-17.)

In June of 1942, at the time the company's books were audited, his employer for the first time discovered that the taxpayer had converted to his own use \$12,748.60 during the year 1941. This amount was composed of miscellaneous sums of money received and collected by taxpayer at different times in his capacity as bookkeeper. Taxpayer failed to deposit the moneys to the credit of his employer but pocketed and withdrew payments in cash made to him by customers and failed to credit the customers' accounts or the employer's accounts receivable with the sums received. (R. 17.)

The taxpayer lost practically all the money in various gambling houses in Reno, Nevada. Taxpayer's employer never condoned or forgave the taking of the money and still holds the taxpayer liable to restore it. (R. 18.)

On July 17, 1942, the taxpayer was arrested and on July 20, 1942, was arraigned in a Nevada state court for the crime of embezzlement of \$22,896.01.¹ He entered a plea of guilty as charged and was sentenced to not less than two nor more than fourteen years of imprisonment. He served this sentence until paroled in the middle of December, 1943. (R. 18.)

The Commissioner determined that the taxpayer was required to report the \$12,748.60 embezzled in 1941 as income in that year and asserted a tax deficiency of \$2,978.09.² (R. 9.) The Tax Court sustained the Commissioner. (R. 20.) The court below reversed the decision of the Tax Court. (R. 33.)

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that the embezzled moneys did not constitute taxable gains or profit or income within the meaning of Section 22 (a) of the Internal Revenue Code and in reversing the order of the Tax Court.

¹ The sum of \$10,147.41 was embezzled in the taxable year 1942. (R. 17.)

² This deficiency also reflected an error of \$4 in reported gross income which is not here relevant.

ARGUMENT

Embezzled money constitutes taxable income to the embezzler under the broad provisions of Section 22 (a) of the Internal Revenue Code

Section 22 (a) of the Internal Revenue Code, *supra*, defining income for tax purposes, is couched in broad language. *Helvering v. Clifford*, 309 U. S. 331, 334. Nevertheless the court below overruled the Tax Court which held, as it had in several previous cases, that embezzled funds constitute income.³ See *Spruance v. Commissioner*, 43 B. T. A. 221, reversed *sub nom. McKnight v. Commissioner*, 127 F. 2d 572 (C. C. A. 5th); *Kurrle v. Commissioner*, decided January 30, 1941 (1941 B. T. A. Memorandum Decisions, par. 41,085), affirmed 126 F. 2d 723 (C. C. A. 8th). The administrative interpretation is to the same effect as the Tax Court's decisions.⁴ We submit that the decision below was wrong.

Tax liability, it is clear, "may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it

³ The Income Tax Act of 1913, c. 16, 38 Stat. 114, 167, Section II B, defined income as including "gains, profits, and income derived from * * * the transaction of any *lawful* business carried on for gain or profit. * * *." [Italics supplied.] In the Revenue Act of 1916, c. 463, 39 Stat. 756, Section 2 (a), the term "lawful" was deleted.

⁴ G. C. M. 16572, XV-1 Cum. Bull. 82 (1936). It was pointed out that the proceeds of an embezzlement are a gain and that the expenditure of human energy in acquiring them is the labor involved within the meaning of Regulations 103, *supra*.

reasonable and just to deal with him as if he were the owner, and to tax him on that basis". *Burnet v. Wells*, 289 U. S. 670, 678. Hence the Government may tax not only ownership, but also "any right or privilege that is a constituent of ownership." *Ibid.* Section 22 (a) has been held by this Court in other situations to embody an exercise of the power to tax as income the acquisition of benefits other than ownership. *Helvering v. Clifford*, *supra*; *Helvering v. Horst*, 311 U. S. 112. Equally, we submit, should the acquisition of benefits by the embezzler of property or funds be regarded as the receipt of income by him.

The act of appropriating property to one's own use is an exercise of a major power of ownership even though the act is consciously and entirely wrongful. Indeed, as against all the world except the true owner the embezzler or thief is the legal owner, at least while he remains in possession. Pollock & Wright; *Essay on Possession* (1888) pp. 91, 151-152; 7 Holdsworth, *History of English Law*, p. 429; *Anderson v. Gouldberg*, 51 Minn. 294 (1892). In a case like the present the command of the wrongdoer over the funds taken is emphasized by the use made of them; for he gambled them away, dissipating them permanently in the purchase of personal satisfactions.

In *Kurrle v. Commissioner*, *supra*, the Circuit Court of Appeals for the Eighth Circuit gave effect to the view here urged by holding embezzled

funds to be taxable income. The court below (R. 33) attempted to distinguish that case upon the ground that the embezzler there "treated said funds as if his own" in a profitable enterprise." This attempted distinction breaks down, however; for in the *Kurrle* case the embezzler was a conscious wrongdoer who used the ill-gotten gains in market operations. In both cases there was a finding by the trial court that the embezzler treated the funds as his own. The fact that in the *Kurrle* case the use of the funds resulted in a profit,⁵ while in the present case they were lost, does not change the character of the dominion under which they were used. There is nothing in the opinion in the *Kurrle* case which has reference to any such distinction or lessens the authority of the decision as a holding that the dominion assumed by an embezzler for his own benefit produces income to him.

In *National City Bank of New York v. Helvering*, 98 F. 2d 93, the Circuit Court of Appeals for the Second Circuit adopted the principle that embezzled funds constitute taxable income to the embezzler, although the court had previously stated the contrary in *Rau v. United States*, 260 Fed. 131, 136. In the opinion in the *National City Bank* case it was recognized (p. 96) that "the weight of authority is against" the view earlier expressed, which, moreover, the court character-

⁵ The profits were, of course, also held to be taxable income.

ized as "wrong in principle." The *National City Bank* case involved certain bonds which one O'Neil had retained as his own although they belonged to the corporation of which he was president. The Circuit Court of Appeals remarked (p. 95) that although the bonds were the property of the corporation in the sense that it could have reclaimed them, "if he [O'Neil] holds with claim of right, he should be taxable as an owner, regardless of any infirmity of his title." [P. 96, italics supplied.] It is evident that that court did not use the term "claim of right" in the sense of strictly lawful claim, nor did it interpret this Court's statement in *North American Oil v. Burnet*, 286 U. S. 417, 424 (*infra*, p. 11), in the narrow sense urged by the taxpayer here. Consciousness of guilt does not negative the fact of beneficial dominion over property, to which Section 22 (a) attaches tax liability.

In other situations the taint of illegality does not remove a taxpayer's receipts from the income upon which a tax must be paid, *Johnson v. United States*, 318 U. S. 189 (income arising from illegal gambling); *United States v. Sullivan*, 274 U. S. 259 (income arising from prohibited transactions with respect to the sale of liquor); *Caldwell v. Commissioner*, 135 F. 2d 488 (C. C. A. 5th) (money received by a state official as bribes from contractors for the securing of state contracts and other favors); and this is true even though the recipient is under an obligation to make restitu-

tion to the persons wrongfully deprived, *Chadick v. United States*, 77 F. 2d 961 (C. C. A. 5th), certiorari denied, 296 U. S. 609, and *Barker v. Magruder*, 95 F. 2d 122 (App. D. C.) (usurious interest); *Chicago, R. I. & P. Ry. Co. v. Commissioner*, 47 F. 2d 990 (C. C. A. 7) (railroad overcharges). Certainly tax liability does not turn upon distinctions which operate in inverse ratio to the degree of the taxpayer's criminality. Thus, funds received as ransom money have been held to constitute taxable income. *Humphreys v. Commissioner*, 125 F. 2d 340 (C. C. A. 7th), certiorari denied, 317 U. S. 637. It sets up a fanciful distinction to assert, as did the court below (R. 33), that in such a case the kidnaper has a claim of right because the money came to him from the owner "by the latter's conscious act, in response to a claim for an agreed service."

The fact that an embezzler may, in the future, be required to make restitution of the funds which he has appropriated and used as his own does not establish his immunity from taxation upon them. His legal liability, which is unquestioned, does not negative the crime involved in the appropriation or the benefits which accrue to the taker by reason of it. Even an actual intent by the taker at the time of the taking to restore the embezzled funds leaves him guilty of the offense, because an intent to use another's property without permission in such a manner as to incur great risk of loss is a sufficient criminal intent. *People v. Nevin*, 343

Ill. 597 (1931); *Commonwealth v. O'Connell*, 274 Mass. 315, 321-322 (1931); *State v. Trolson*, 21 Nev. 419 (1893); *State v. Liliopoulos*, 167 Wash. 686, 690 (1932). See Clark & Marshall on *Crimes* (4th ed., 1940), pp. 426, 428-429; Miller, *Handbook of Criminal Law* (1934), 365-367. The intent to make restitution neither negatives criminality nor changes the actual character of the gain which the wrongdoer accomplishes for himself.

It is significant that under the income tax laws a debt and the liability created by a theft are differently treated. As to the former, default by the debtor may give rise to a deductible loss only when the debt becomes worthless, whereas a theft creates a deductible loss from the beginning. Internal Revenue Code, §§ 23 (e), 23 (k) (1), 26 U. S. C. 23 (e), 23 (k) (1); *First National Bank v. Heiner*, 66 F. 2d 925 (C. C. A. 3); compare *John H. Farish & Co. v. Commissioner*, 31 F. 2d 79 (C. C. A. 8), where the money taken was not the taxpayer's but trust funds owing to clients; and see *Burnet v. Huff*, 288 U. S. 156. This distinction between bad debts and losses by theft is realistic and should carry over into the determination of an obligor's tax liability upon the sums which he has received. The income to the embezzler accrues at the time of the theft, not at some theoretical later time when the remote possibility of restitution is somehow extinguished.

The court below (R. 32) based its decision partly upon a theory derived from a statement of

this Court in *North American Oil v. Burnet*, 286 U. S. 417, 424, that—

If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.⁶

Nothing in that case warrants the adoption of such a theory, however, for in the *North American Oil* case there were no illegal gains involved. The income in question consisted of income from property which a receiver held impounded pending litigation between the United States and the North American Oil Company as to its beneficial ownership.⁷ Income earned in 1916 was turned over to the company in 1917 upon entry of a final decree in the district court dismissing the bill of the United States. The appellate phases of the litigation were finally terminated favorably to the taxpayer in 1922. The question was whether the income should have been reported by the company in 1916, 1917, or 1922. This Court held (p. 424) that the profits became income of the company in 1917, "when it first became entitled to them and when it actually received them."

⁶ See also G. C. M. 16730, XV-1 Cum. Bull. 179 (1936).

⁷ As stated (p. 422), it was "conceded that the net profits earned by the property during the receivership constituted income."

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⁶ See also G. C. M. 16730, XV-1 Cum. Bull. 179 (1936).

⁷ As stated (p. 422), it was "conceded that the net profits earned by the property during the receivership constituted income."

Hence it appears that the statement in the opinion, quoted above, had reference to a situation in which the taxpayer took under a claim of right, and it cannot be understood to negative the possibility of taxable income without such a claim or to have been intended to mark the outermost limits of the concept of income. The attempt so to apply it here is, we submit, inadmissible.

CONCLUSION

We think it is clear that under the broad concept of income embezzled funds constitute income to the embezzler. He is the recipient of virtually all benefits of ownership during the taxable year in which he obtains the money. The absence of a claim of right or the existence of a duty to make restitution, like illegality in the acquisition of money or property in certain other situations, should not control the statutory meaning of income.

For these reasons, the judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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DECEMBER 1945.